

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Judgment Reserved On 30.07.2019	Judgment Pronounced On 05.08.2019
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CORAM:

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case (Appeal) No.568 of 2008
and
Tax Case Appeal No.38 of 2009

T.C.(A) No.568 of 2008:-

Commissioner of Income Tax VII,
Chennai. .. Appellant/Respondent

-vs-

M P Purushothaman
59, Harris Road,
Pudupet, Chennai-600 002. .. Respondent/Appellant

APPEAL under Section 260A of the Income-tax Act, 1961
against the order dated 17.10.2007 on the file of the Income-tax
Appellate Tribunal Bench 'B', Chennai in I.T.A.No.626/Mds/07 for
the assessment year 2002-03.

TCA.No.568/2008 : Against the order of the Income Tax Appeals
Chennai -600 034, dated 15.12.2006 in ITA.No.32/2006-07.

Against the order of the Assistant Commissioner of Income
Tax Central Circle(2), Chennai -600 034 dated 29.03.2016
PANGIR.No.AGMPP4159R in the assessment year 2002-03.

T.C.A.38 of 2009:-

The Commissioner of Income Tax,
Tamil Nadu-VII, Chennai. .. Appellant/Appellant

-vs-

Shri.M.P.Purushothaman
No.59, Harris Road,
Pudupet, Chennai-600 002.
PAN AGMPP 4159 R .. Respondent/Respondent

APPEAL under Section 260A of the Income-tax Act, 1961 against the order dated 04.07.2008 on the file of the Income-tax Appellate Tribunal Bench 'B', Chennai in I.T.A.No.508/Mds/07 for the assessment year 2002-03.

TCA.No.38/2009 : Against the order of the Income Tax Appeals Chennai -600 034, dated 15.12.2006 in ITA.No.32/2006-07 in the Assessment year 2002-03.

Against the order of the Assistant Commissioner of Income Tax Central Circle(2), Chennai -600 034 dated 29.03.2016 PANGIR.No.AGMPP4159R in the assessment year 2002-03.

For Appellant : Mr.S.Rajesh,
(In both Appeals) Standing Counsel
For Respondent : Mr.A.S.Sriraman
(In both Appeals)

COMMON JUDGMENT

T.S.Sivagnanam, J.

These appeals have been filed by the Revenue under Section 260A of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), challenging the orders dated 17.10.2007 and 04.07.2008 passed by the Income-tax Appellate Tribunal Bench 'B', Chennai ("the Tribunal", for brevity) in I.T.A.No.626/Mds/07 and I.T.A.No.508/Mds/07 for the assessment year 2002-03 respectively.

2.The reason for preferring two appeals is on account of the fact that aggrieved by the order passed by the Commissioner of Income-tax (Appeals)-I, Chennai (for brevity, "the CIT(A)"), dated 15.12.2006, the assessee as well as the Revenue filed appeals before the Tribunal and two separate orders were passed by the Tribunal accepting the case of the assessee and this being the reason, the Revenue has filed two tax case appeals.

3.A decision in T.C.(A) No.568 of 2008 would cover both cases. The appeal was admitted, on 03.07.2008, on the following substantial question of law:-

"Whether on the facts and circumstances of the case, the Tribunal was right in holding that the price shown @ Rs.14.75 per share should be accepted as genuine, when the same shares were sold by the company for Rs.127 per share?"

4.The assessee is the Chairman and Managing Director of M/s.Empee Distilleries Ltd. A search was conducted in the business premises of the company and the residence of the assessee was also searched.

5.The Revenue would state that it was found that the assessee and his family members had sold their shares to M/s.McDowell Alcobev Ltd., at Rs.14.25 per share when the remaining share held by M/s.Empee Sugars & Chemicals Ltd., were sold at Rs.127.35 per share. The assessee received Rs.10 Crores as non compete fee which he claimed was not taxable. The Assessing Officer found that the price of the same shares was sold at a much higher price in the hands of Empee Sugars & Chemicals Ltd., who had huge accumulated losses which could be set off against the capital gains and in the hands of the assessee, it was artificially lower and split into consideration for shares and non compete fee to evade taxes. The Assessing Officer disbelieved the stand of the assessee that the amount was paid towards non compete fee and added the same to the price received for sale of shares, and charged the same to capital gains.

6.Aggrrieved by the order of assessment, the assessee filed appeal before the CIT(A), who held that the non compete fee should not be disturbed, but the high amount charged to Empee Sugars & Chemicals Ltd., should be treated as having been partly for shares sold by the assessee. Accordingly, the CIT(A) treated Rs.8,79,13,221/- as capital gains of the assessee, and that the same should be reduced from the gains in the hands of Empee Sugars & Chemicals Ltd.

7.The assessee preferred appeal to the Tribunal. The Tribunal held that notional capital gains cannot be taxed, and that the price for which the shares were agreed to be sold by the assessee was a reasonable price. Accordingly, the appeal filed by the assessee was allowed.

8.Mr.S.Rajesh, learned Standing Counsel for the appellant/Revenue contended that the entire share holding of Empee Distilleries Ltd., had been transferred to McDowell's and while 51% of the shares held by the assessee and his family were valued at Rs.14.25 shares, the balance held by another company owned by the assessee, that is, Empee Sugars & Chemicals was sold at Rs.127, which clearly shows that the price shown by the assessee is not a genuine one.

9.It is further submitted that the Tribunal should have considered the fact that the assessee not only received Rs.14.25 paise per share, but also a non compete fee of Rs.10 Crores. Further, it is submitted that the Tribunal erred in holding that nothing was found during the search with regard to the seized material when there is a specific reference made by the Assessing Officer to the seized materials.

10.Further, it is contended that the finding of the Tribunal that the addition has been made on the basis of Board Resolution which was done behind the back of the assessee, is not supported by any material, nor there is any reference in the assessment order and therefore, the observation of the Tribunal is on assumptions.

11.The learned Standing Counsel placed reliance on the decisions in Lachminarayan Madan Lal vs. CIT reported in [1972] 86 ITR 439 (SC); and Mc Dowell & Co. Ltd., vs. Commercial Tax Officer reported in [1985] 154 ITR 148 (SC).

12.Mr.A.S.Sriraman, learned counsel appearing for the respondent/assessee sought to sustain the order passed by the Tribunal firstly by contending that there is absolutely no seized material emanating out of the search and seizure operations warranting assessment under Section 153C of the Act. In this regard, the learned counsel placed reliance on the decision in the case of CIT vs. Sinhgad Technical Education Society reported in [2017] 397 ITR 344.

13.It is further submitted that whatever material which is said to have been seized were all disclosed by the assessee about one year back, when the returns were filed, and the present assessment could not have been done with those material. It is further submitted that the non compete fee which was received by the assessee pursuant to an agreement dated 30.03.2002, should always be treated as a capital receipt especially when, there is a negative covenant restraining the assessee from commencing identical business that was transferred to McDowell's for a period of seven years. Further, it is submitted that the consideration received for transfer of shares was duly accounted for and offered for tax. Therefore, it is submitted that this non compete fee cannot be taxed by the Department.

14.To support his submissions, reliance was placed on the decision of the Hon'ble Supreme Court in Guffic Chem (P) Ltd., vs. CIT & Anr. reported in (2011) 332 ITR 0602.

15.The learned counsel has referred to the return of income for the assessment year 2002-03 along with the computation to show that all details were disclosed one year prior to the search and seizure operations and there is no material with the Assessing Officer to invoke Section 153 of the Act.

16.In reply, Mr.S.Rajesh would contend that the power under Section 153 of the Act includes power to assess and re-assess and the Assessing Officer has clearly brought out the materials

which were seized which is the basis of the assessment under Section 153C of the Act.

17.We have heard learned counsel for the parties.

18.A search under Section 132 of the Act was conducted in the business premises of M/s.Empee Distilleries Ltd., on 25.11.2003 and concluded on 05.01.2004. The residence of the Chairman and Managing Director of Empee Distilleries Ltd., the assessee, was also searched. The assessee, his two sons, his two daughters and his wife are the Directors of several companies which formed the Empee Group. The search resulted in seizure of cash of Rs.1 Crore from the residence of the assessee, gold weighing 5856.4 grams and diamonds of 87.06 carats. Gold weighing 978.9 grams and diamonds of 17.31 carats were seized from the residence of one of the two sons of the assessee.

19.On the basis of the materials found and seized during the course of search, and after recording satisfaction, a notice under Section 153C was issued on 04.01.2005. The assessee was granted 30 days' time, from the date of receipt of the notice, to file his return of income in respect of the notice under Section 153C of the Act. The assessee filed his return of income on 29.07.2005, without offering any additional income than what was admitted in his return originally filed on 20.10.2002. Pursuant to notice issued under Section 143(2) dated 23.08.2005, the authorised representative of the assessee appeared before the Assessing Officer and filed details. Subsequently, notice under Section 142(1) dated 07.12.2005, was issued along with questionnaire in which, details were called for.

20.The assessee was called upon to show cause as to why the non compete fee of Rs.10 Crores should not be brought to tax in view of the facts brought out as a result of search. The assessee filed his reply dated 20.03.2006. The Assessing Officer, upon analysing the transaction as a whole, held that it is a device employed by the assessee to avoid tax and accordingly, the sum of Rs.10 Crores received by the assessee has the character of capital gains on transaction of shares and the income was taxed at 20%.

21.The assessee preferred appeal before the CIT(A), who by order dated 15.12.2006, allowed the appeal in part.

22.The assessee and the Revenue filed appeals before the Tribunal. The assessee's appeal was allowed by the Tribunal. Consequently, the Revenue's appeal was dismissed. This is how, the Revenue is before us by way of these appeals.

23. In the show cause notice issued to the assessee pursuant to the search and seizure operations, it was stated that the seized material contains documents relating to transfer of M/s. Empee Breweries Ltd., as a growing concern to M/s. McDowell Alcobev Ltd., and an asset purchase agreement was drawn between Empee Distilleries Ltd., and Empee Breweries Ltd., for transferring the plant and machineries of Empee Distilleries Ltd., to Empee Breweries Ltd., which had its brewing division in Sriperumpudur. The assessee and his family members have controlling shares in Empee Distilleries Ltd., Empee Breweries Ltd., and Empee Sugars & Chemicals Ltd. The transfer of assets had taken place, as a result of an agreement between the assessee and his family members with McDowell Alcobev Ltd. The assessee and his family agreed to sell 29,75,375 number of shares at an agreed price of Rs.14.25 per share and these shares formed 51.08% of the total shares floated by Empee Breweries Ltd. McDowell Alcobev Ltd., and Empee Distilleries Ltd., sold all their shares (48.92%) to Empee Sugars & Chemicals Ltd., at a price of Rs.10 per share on 02.04.2002, and the assessee and his family members, Empee Distilleries Ltd., Empee Breweries Ltd., and Empee Sugars & Chemicals Ltd., entered into an agreement with McDowell Alcobev Ltd. Empee Distilleries Ltd., sold their shares to Empee Sugars & Chemicals Ltd., for Rs.10/- and the assessee and his family members sold the same shares to McDowell Alcobev Ltd., at Rs.14.25 per share and Empee Sugars & Chemicals Ltd., sold the newly acquired shares to McDowell Alcobev Ltd., at Rs.127.35 per share, i.e., at 12 times profit ratio. The assessee and Empee Distilleries Ltd., who had sold their shares at 12 times lower price, were granted a non compete fee and the assessee received Rs.10 Crores as his share of non compete fee and Empee Distilleries Ltd., Rs.7 Crores. Empee Distilleries Ltd., and the assessee claimed that the receipts were capital in nature and hence, did not offer the same to tax.

24. The Assessing Officer was of the prima facie view that the non compete fee should be taxed in the hands of the assessee considering the chain of events noted by him. The assessee, in their reply, contended that the non compete fee of Rs.10 Crores is accounted for in the books of accounts for the year ended 31.03.2002 and the reason for effecting such payment is set out in the agreement dated 30.03.2002 and that the assessee had entered into a share purchase agreement dated 18.01.2002 with Empee Distilleries Ltd., for sale of equity shares in Empee Breweries Ltd., owned and controlled by the assessee and his family members. Further, the assessee stated that by asset purchase agreement dated 28.02.2002, Empee Breweries Ltd., purchased operating assets and licences of the Brewery unit from Empee Distilleries Ltd., and in terms of the share purchase agreement, the assessee transferred the entire shares held by

him and his family members in Empee Breweries Ltd., to McDowell Alcobev Ltd.

25.The assessee contended that there is no material to warrant the conclusion that the transaction is a colourable device to avoid tax. It was stated that the sum of Rs.10 Crores paid to the assessee is the consideration as per agreement dated 30.02.2002 for accepting restrictive covenant in the aforesaid agreement. Further, the assessee contended that Empee Breweries Ltd., is a public limited company in which, public are not substantially interested and he and his family members held more than 50% of the shares in the company, its performance had not been encouraging and the said buyer agreed to purchase the shares, but insisted that the restrictive covenant should be accepted and to accept the same, Rs.10 Crores was paid to the assessee.

26.Further, it was stated that the share purchase agreement and non compete fee agreement have been acted upon and are genuine. Copies of those agreements were also filed before the Assessing Officer. It was submitted that every attempt of tax planning cannot be treated as illegitimate and must not be looked upon with disfavour. This explanation furnished by the assessee was considered by the Assessing Officer and it was held that the reason for sale of shares at a low price of Rs.10 and 14.25 paise where the sale price could have been Rs.127.35 has not been satisfactorily explained. The company, Empee Sugars & Chemicals Ltd., is controlled by the same Directors has effected a sale to McDowell Alcobev for Rs.127.35 paise within a short span of time. Explaining the nature of transaction, the Assessing Officer pointed out that what has been sold to Empee Distilleries Ltd., which is a group company for Rs.10, is sold back by the other company, Empee Sugars & Chemicals Ltd., at Rs.127.35 paise to Empee McDowell Ltd., and this capital gain is set off against the losses of Empee Sugars & Chemicals Ltd.

27.Further, it was pointed out that the capital gains arising out of the sale of shares at the price of Rs.127.35 paise by Empee Sugars & Chemicals Ltd., does not suffer tax because, Empee Sugars has accumulated losses that have not been exhausted. Thus, the Assessing Officer concluded that the transaction was not genuine. Furthermore, it was pointed out that the transactions of selling shares at a lower price cannot be viewed as a singular event for judging the genuineness and if the transactions are perceived as a whole, it shows the device employed by the assessee to avoid tax, more so when the assessee and Empee Distilleries Ltd., were under no compulsion to sell their shares at very low prices after initiating the arrangement for handing over Empee Breweries Ltd. It was noted by the Assessing Officer that nothing has changed since their sales for

low prices, till the time the shares were sold for Rs.127.35 paise. Accordingly, the stand taken by the assessee was rejected and the assessment was completed.

28. On appeal before the CIT(A), it was held that non compete fee should not be disturbed, but the high amount charged to Empee Sugars & Chemicals Ltd., should be treated as having been partly for the shares sold by the assessee. Accordingly, a sum of Rs.8,79,13,221/- was treated as capital gains of the assessee and the same should be reduced from the gains in the hands of Empee Sugars & Chemicals Ltd.

29. Aggrieved by the same, the assessee had preferred appeal before the Tribunal. The Tribunal pointed out that the adequacy of consideration is between the transferor and transferee and in the absence of any theory of collusiveness, the value as accepted by the parties represents the full value of consideration. The Tribunal noted that the share purchase agreement was not rejected by the authorities, the agreement was acted upon and the ultimate purchaser was a stranger and the transaction itself is at arms length and the entire fund flow was through banking channel.

30. The Tribunal accepted the stand of the assessee, who placed reliance on the decision of the Hon'ble Supreme Court in K.P.Varghese vs. Income-tax Officer reported in [1981] 131 ITR 597 (SC). The Tribunal observed that the price for which shares are agreed to be sold is a justified reasonable price, as at that time, the brewery licence was not accorded sanction by Government of Tamil Nadu and sanction was granted, subsequently.

31. Further, the Tribunal observed that while reading the full value of consideration, one has to see the value at the time of sale and subsequent events have no relevance for deciding the factor of full value of consideration and the action of the assessee cannot be viewed as to the evasion of tax to apply the legal principal laid down by the Hon'ble Supreme Court in Mc Dowell & Co. Ltd. (supra).

32. We are at a loss to understand as to how the Tribunal came to the conclusion that the price for which the shares are agreed to be sold is a justified reasonable price. Apparently, there was no material which was placed before the Tribunal to arrive at such a finding. More importantly, as rightly pointed out by the Assessing Officer, there was no compulsion on the assessee or Empee Breweries Ltd., to sell their shares at a low price after initiating the arrangements for handing over Empee Breweries Ltd., and the Assessing Officer noted that nothing has changed since their sale for such low prices till the time the

shares were sold for Rs.127.35 paise. Therefore, the finding rendered by the Tribunal that the price for which the shares were agreed to be sold is a justified reasonable price is a finding not supported by any document and therefore, perverse. Further, the Tribunal holds that the assessee's reply for selling their shares at Rs.14.25 per share to McDowell Alcobev is more convincing.

33.On a perusal of the reply given by the assessee dated 20.03.2006, to the show cause notice issued by the Assessing Officer, it is seen that no explanation was offered by the assessee as to why he sold the shares at such low price. The contention of the assessee is that the amount of Rs.10 Crores received by him is towards non compete fee, as McDowell Alcobev Ltd., insisted upon a restricted covenant on the assessee for a period of seven years. Therefore, the finding of the Tribunal that the explanation offered by the assessee for selling the shares at Rs.14.25 to be convincing is not substantiated by any material and therefore, perverse. The Tribunal, further, has observed that besides the search and seizure action on 25.11.2003, under Section 132, both in the case of the assessee and Empee Distilleries Ltd., there is no material relating to the said addition.

34.Further, the Tribunal states that the assessment under Section 153C read with Section 153A and Section 143(3) was framed on the sole reliance of the Board Resolution which was done behind the back of the assessee and such Board Resolution alone cannot be taken as a valid piece of evidence particularly when, it was not confronted to the assessee. The Tribunal had failed to note that the Assessing Officer, at the first instance, while calling upon the assessee to show cause as to why non compete fee of Rs.10 Crores should not be brought to tax, placed reliance on the seized material in file no. Ann/MP/D&D/S.35. There is a specific reference to the same in paragraph 4.2 of the assessment order. Therefore, we fail to understand as to how the Tribunal came to the conclusion that there was no material to frame the assessment under Section 153C of the Act. There has been no attempt made by the Tribunal to examine the seized material which was the basis of the assessment proceedings, papers and documents were recovered from the residence of the assessee and the companies controlled by him. Therefore, to say the least, the finding of the Tribunal, in this regard, is wholly unsubstantiated and without any material and consequently, perverse.

35.Mr.A.S.Sriraman, learned counsel argued that the amount paid to the assessee to refrain from competing with Empee Breweries Ltd./McDowell Alcobev Ltd., has been clearly set down in the non compete agreement dated 30.03.2002, which has been

acted upon by the parties. Therefore, in the light of the said agreement, the stand taken by the Assessing Officer is wholly unsustainable.

36. On a reading of the agreement dated 30.03.2002, it is not clear as to who had represented McDowell Alcobev Ltd., as the agreement does not mention the name of the authorised signatory of the company. The photostat copy which was placed before us contains two signatures in the bottom of pages 1 to 5, and four signatures in page 6. Of the four signatures, one is that of the assessee and two witnesses K. Sethuraman, a third party and the daughter of the assessee Nisha Purushothaman. There is one other signature which does not give any designation or the name of the person, who had signed it. Apart from that, the agreement is an unregistered instrument based on which, the assessee was paid a sum of Rs.10 Crores. The Tribunal appears to have brushed aside important facts more particularly, the sequence of events prior to the share transfer and thereafter.

37. In our considered view, the Assessing Officer rightly considered the entire transaction and came to the conclusion that it is a device employed by the assessee to evade taxes. The finding of the Assessing Officer, in this regard, is justified, as it was found that the assessee and his family members sold their shares to McDowell Alcobev Ltd., at Rs.14.25 paise per share, when the remaining shares held by Empee Distilleries Ltd., were sold by McDowell Alcobev Ltd., at a price of 125.37 and the assessee received Rs.10 Crores as non compete fee which he had claimed was not taxable. The price of the shares which was shown at a much higher price in the hands of Empee Sugars & Chemicals Ltd., was undoubtedly to benefit the company which had huge accumulated losses and consequently, the same could be set off against capital gains. The benefit which will accrue to the assessee is by lowering and splitting up of the consideration for shares and non compete fee thereby being a device employed to evade tax.

38. The question would be as to whether merely because there was a non compete agreement, will it absolve the assessee. This issue was considered in Lachminarayan Madan Lal (supra) wherein, it was pointed out that mere existence of an agreement between the assessee and its selling agents or payment of certain amounts as commission, assuming there was such payment did not bind the Income-tax Officer to hold that the payment was made exclusively and wholly for the purpose of the assessee's business. It was further pointed out that although there might be such an agreement in existence, and payments might have been made, it was still open to the Income-tax Officer to consider the relevant factors and determine for himself whether the commission said to have been paid to the selling agents or any

part thereof was properly deductible under Section 37 of the Act. This decision is a clear answer to the stand of the assessee and by applying the same, the stand taken by the assessee deserves to be out rightly rejected.

39. In the decision in *Mc Dowell & Co. Ltd.* (supra), it was pointed out that it is open to everyone to so arrange his affairs as to reduce the brunt of taxation to the minimum, tax planning may be legitimate provided, it is within the framework of law; colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It was pointed out that it is the obligation of every citizen to pay tax honestly without resorting to subterfuges. It was held that Courts are now concerning themselves not merely with the genuineness of a transaction, but with an intended effect of it for fiscal purposes and no one can now get away with a tax avoidance project with the mere statement that there is nothing illegal about it. Having held that the modus adopted by the assessee is a device to avoid tax, we have no hesitation to interfere with the order passed by the Tribunal.

40. The assessee has placed reliance on *K.P. Varghese* (supra).

41. We find the judgment to be wholly inapplicable to the facts of the case and reliance on it is misplaced.

42. Mr. A.S. Sriraman, argued that the Tribunal had out rightly held that there was no incriminating material seized during the search operations and no assessment could have been done under Section 153C of the Act. To support his argument, reliance was placed on the decision in *Sinhgad Technical Education Society* (supra).

43. In the preceding paragraphs, we have analysed the factual details as culled out by the assessee and found that the assessee has specifically recorded the materials which were seized during the search operations which were brushed aside by the Tribunal in a single line order. Therefore, the decision in *Sinhgad Technical Education Society* (supra), can be of no assistance to the case of the assessee.

44. Reliance was placed on *Guffic Chem (P) Ltd.* (supra) to state that non compete fee is a capital receipt.

45. We cannot be compelled to go thus far because, we have concurred with the view taken by the Assessing Officer that the payment of non compete fee was a colourable device adopted by the assessee to avoid tax. Therefore, the decision in *Guffic Chem (P) Ltd.* (supra) does not in any manner help the case of the assessee.

46.For the above reasons, the Revenue has to succeed in these appeals.

47.In the result, the appeals are allowed, the orders passed by the Tribunal and the Commissioner of Income-tax (Appeals)-I, Chennai, are set aside and the assessment order is restored. No costs.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

To

- 1.The Assistant Commissioner of Income-tax,
Central Circle I(2) (i/c), Chennai-600 034.
- 2.The Commissioner of Income-tax (Appeals),
Chennai-600 034.
- 3.The Income-tax Appellate Tribunal Bench 'B', Chennai.
Rajaji Bhavan, Besant Nagar.

+2cc to Mr.S.Sridhar, Advocate SR.No.66578 and 66579
+1cc to Mr.Karthik Ranganathan, Standing Counsel SR.No. 66556

AKM/05.09.19 /12P-7C/

Judgment made in
T.C.(A) No.568 of 2008
AND T.C.A.No.38 of 2009

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